How does bankruptcy affect family law proceedings?

Bankruptcy is stressful enough, but when family law proceedings become part of the situation, it takes on another level of complexity.

Whether it's the bankrupt or the non-bankrupt spouse, there's no denying bankruptcy can be distressing as well as complicated when it collides with a family law matter. However, at whatever stage someone becomes bankrupt, if they are involved in family law proceedings, they need to notify the court.

Under legislation, the Federal Circuit and the Family Court of Australia have jurisdiction under the Family Law Act 1975, to deal with a bankruptcy of a party in a marriage or de facto relationship in court proceedings for the following:

- property settlement, and/or
- declaration on interest in property, and/or
- setting aside property orders, and/or
- spouse maintenance,
- de facto partner maintenance, and/or
- enforcement of any of the above orders.

The Court will deal with three types of property: property that has vested in the trustee; property that has not vested in the trustee; and the non-bankrupt spouse's assets. It will also consider various factors in determining a property settlement, including:

- identifying property/determining its value in respect of the parties
- defining whether it's 'just and equitable' to make an order
- determining the extent to which each party contributed to the property pool and the relationship generally (both financial and non-financial contributions)
- considering the needs of each party going forward
- determining whether the Order to be made is just and equitable.

The Court will also consider the effect/impact of any Order on the ability of creditors of the Bankrupt to recover any part of their debts. From the perspective of the Bankruptcy Trustee, the aim is to reach an agreement in respect to those assets the subject of the bankruptcy. The Trustee has no interest in other matters pertaining to the proceedings or proposed action by the non-bankrupt party and on commercial grounds alone, the Trustee will be mindful to reach a consensus on this point.

Bankruptcy effects

When someone becomes bankrupt, their divisible property vests in the bankruptcy trustee and consequently, if family law proceedings are in process, the bankrupt no longer has the capacity to deal with those assets or to negotiate with the non-bankrupt party.

A trustee may elect to become a party to family law proceedings which:

- have already commenced at the date of bankruptcy; or
- are subsequently commenced by the non-bankrupt party.

It can also follow that a trustee may be added as a respondent to the proceedings.

Some property is excluded from bankruptcy proceedings, such as a motor vehicle, tools of the trade – up to a certain value, and most household items. Meanwhile, the non-bankrupt party doesn't have priority over other creditors but can apply for an injunction to prevent the trustee from declaring or distributing dividends or assets among creditors before the property settlement is completed.

Experience suggests that a trustee is better served to avoid involvement and to enter into discussions with the non-bankrupt party and/or legal representative with a view to reaching a consensus, which can ultimately be presented to the Court. This is easier said than done, as determining a property settlement situation when emotions are running high is difficult – this will often lead to the trustee being joined in the matter.

Becoming involved in the proceedings can be a costly exercise for the bankrupt estate as legal costs will be incurred. The trustee will, of course, consider the commerciality of the process as against the trustee's own time costs, the extent of the asset values (the subject of the proceedings), and the amount owed to the bankrupt's creditors.

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